THUNDERBIRD
SCHOOL OF GLOBAL MANAGEMENT

Solutions to the 13 Biggest Finance, Management and Marketing Problems that Affect Entrepreneurs and Businesses

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The 13 Biggest Problems of Doing Global Business

1. Focusing – Knowing what business you should be in and then focusing on its operation
2. Seeking advice and establishing the right organizational form and structure
3. Switching from an entrepreneur to a corporate entrepreneur – giving up some control
4. Attracting and retaining employees

The 13 Biggest Problems of Doing Global Business *(cont.)*

5. Growing outside and choosing the right partner
6. Flexibility and Creativity – Making changes when needed
7. Building a lasting business
8. Market niching and customer focus
9. Going international successfully

The 13 Biggest Problems of Doing Global Business *(cont.)*

10. Knowing how to successfully grow a business
11. Raising capital
12. Managing the cash flow
13. Valuing a business

Problem 1
Focusing

Aspects of the Entrepreneurial Process

Identify and Evaluate the Opportunity	*Develop Business Plan*	*Resources Required*	*Manage the Enterprise*
• Creation and length of opportunity • Real and perceived value of opportunity • Risk and returns of opportunity • Opportunity versus personal skills and goals • Competitive environment	• Title Page • Table of Contents • Executive Summary 1. Description of Business 2. Description of Industry 3. Marketing Plan 4. Financial Plan 5. Production Plan 6. Organization Plan 7. Operational Plan 8. Summary • Appendices (Exhibits)	• Existing resources of entrepreneur • Resource gaps and available supplies • Access to needed resources	• Management style • Understand key variables for success • Identify problems and potential problems • Implement control systems • Develop growth strategy

Determining the Need for a New Product Idea

Factor	Aspects	Competitive Capabilities	New Product Ideas Capability
Type of need			
Continuing need			
Declining need			
Emerging need			
Future need			
Timing of need			
Duration of need			
Frequency of need			
Demand cycle			
Position in life cycle			
Competing ways to satisfy need			
Doing without			
Using present way			
Modifying present way			
Perceived benefits/risks			
Utility to customer			
Appeal characteristics			
Customer tastes and preferences			
Buying motives			
Consumption habits			
Price versus performance features			
Price-quantity relationship			
Demand elasticity			
Stability of price			
Stability of market			
Market size and potential			
Market growth			
Market trends			
Market development requirements			
Threats to market			
Availability to customer funds			
General economic conditions			
Economic trends			
Customer income			
Financing opportunities			

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Determining the Value of a New Product Idea

Value Consideration	Cost (in $)
Cash outflow	
R&D costs	
Marketing costs	
Capital equipment costs	
Other costs	
Cash inflow	
Sales of new product	
Effect on additional sales	
Salvageable value	
Net cash flow	
Maximum exposure	
Time to maximum exposure	
Duration of exposure	
Total investment	
Maximum net cash in a single year	
Profit	
Profit from new product	
Profit affecting additional sales of existing products	
Fraction of total company profit	
Relative return	
Return on shareholder's equity (ROE)	
Return on investment (ROI)	
Cost of capital	
Present value (PV)	
Discounted cash flow (DCF)	
Return on assets employed (ROA)	
Return on sales	
Compared to other investments	
Compared to other product opportunities	
Compared to other investment opportunities	

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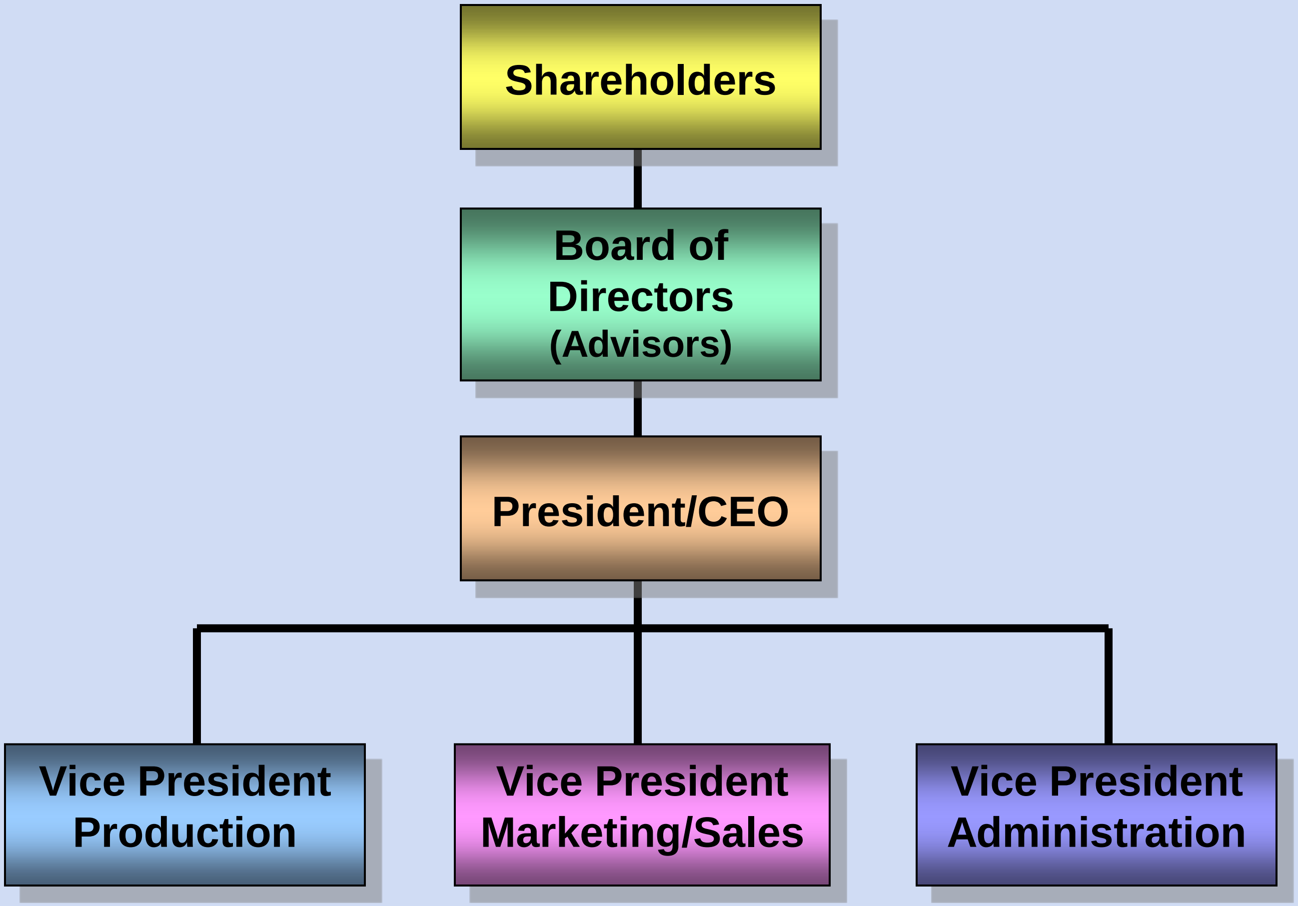
Problem 2
Establishing the Best Organizational Form

Corporate Organizational Forms in the U.S.

- LLC
- SC
- C Corporation
- Professional Corporation
- Not-for-Profit Corporation
- Hybrid Corporation

Stage 1 – Organizational Design



Problem 3
Giving up Control

Corporate Entrepreneurship Formula

$CE = CI + O + C^2$

Where :

I = Level of Corporate Entrepreneurship

CI = Commitment to Innovation

O = Ownership

C = Creativity

C = Change

Nine Steps to Transforming Your Organization

1	**Establish A Sense Of Urgency** • Examining market and competitive realties • Identifying and discussing crises, potential crises, or opportunities • Develop appropriate guidelines for time frame • Implementation must be achievable within the existing scope of organizational resources
2	**Forming A Powerful Guiding Coalition** • Assembling a group with enough power to lead the change effort • Encouraging and allow the group to work together as a team • Organize a team of established leaders who can implement and obtain buy-in of others and also work toward organizational goals without blocking tasks with personal agendas
3	**Creating A Vision Of End Result** • Creating a vision to help direct the change effort • Developing a strategic plan (mission, goals/objectives, strategies/tactics) for achieving that vision
4	**Communicating The Vision** • Using every vehicle possible to communicate the new vision & Strategies • Teaching new behaviors by example of the guiding coalition • Measuring progress toward the end goal must be visible and continually communicated to all
5	**Selecting A Champion** • Selecting a champion that can spearhead the transformation • Champion needs to be able to communicate the vision in a powerful way
6	**Empowering Others To Act On The Vision** • Getting rid of obstacles to change • Changing systems that undermine the vision & discourage risk taking • Rewarding creative thinking & implementation at any level • Acknowledge that employees are the ones responsible for achieving success
7	**Planning For And Creating Short-Term Wins** • Planning for visible performance improvements • Recognizing and rewarding employees involved in the improvements with more than token rewards • Stair step achievements: Winning small battles to “win the war” • Build in accomplishments which lead to the end goal and reward those that add value to that achievement
8	**Consolidating Improvements & Producing Still More Changes** • Using increased credibility to change systems, structures and policies • Hiring, promoting, and developing employees who can implement the vision • Giving employees the opportunity to initiate changes
9	**Institutionalizing New Approaches** • Articulating the connections between new behaviors and success • Developing the means to ensure leadership development and succession • Standardizing the process for all future change initiatives

Adopted from: John P. Kotter, “Leading Change: Why Transformation Efforts Fail”, *Harvard Business Review* (March-April, 1995), pp. 59-62.

Corporate Entrepreneurial Environment

- Organization operates on frontiers of technology
- New ideas encouraged
- Trial and error encouraged
- Failures allowed
- No opportunity parameters
- Resources available and accessible
- Multidiscipline teamwork approach
- Long time horizon
- Volunteer program
- Appropriate reward system
- Sponsors and champions available
- Support of top management

Corporate Entrepreneurship Planning Guide

- **Executive Summary**
- **Corporate Fit**
  - Product fits into corporate goals
  - Customer base
  - Utilization of assets
  - Staff needs
  - Effect on business community

Corporate Entrepreneurship Planning Guide *(cont.)*

- **Product/Service Analysis**
  - Purpose of the product/service
  - Stage of development
  - Product limitation
  - Proprietary rights
  - Government approvals
  - Product liability
  - Related services and spin-offs
  - Production

Corporate Entrepreneurship Planning Guide *(cont.)*

- **Market Analysis**
  - Current market size
  - Growth potential of the market
  - Industry trends
  - Competition profile
  - Customer profile
  - Customer benefits
  - Target markets
  - Market penetration

Corporate Entrepreneurship Planning Guide *(cont.)*

- **Price and Profitability**
  - Price list
  - Sales estimate
  - Cost of product/service
  - Gross margin
  - 3-year operating expenses
  - 3-year operating statement
  - Start-up costs
  - Start-up expenses
  - Capital expenditures

Corporate Entrepreneurship Planning Guide *(cont.)*

- **Plan for Further Action**
  - Pitfalls
  - Positives
  - Needed capital
  - Role of corporate entrepreneurial manager
  - Business plan
  - License potential
  - Corporate partners
  - Proprietary rights
  - Corporate staff
  - Corporate entrepreneurship executive board

Characteristics of a Corporate Entrepreneurial Leader

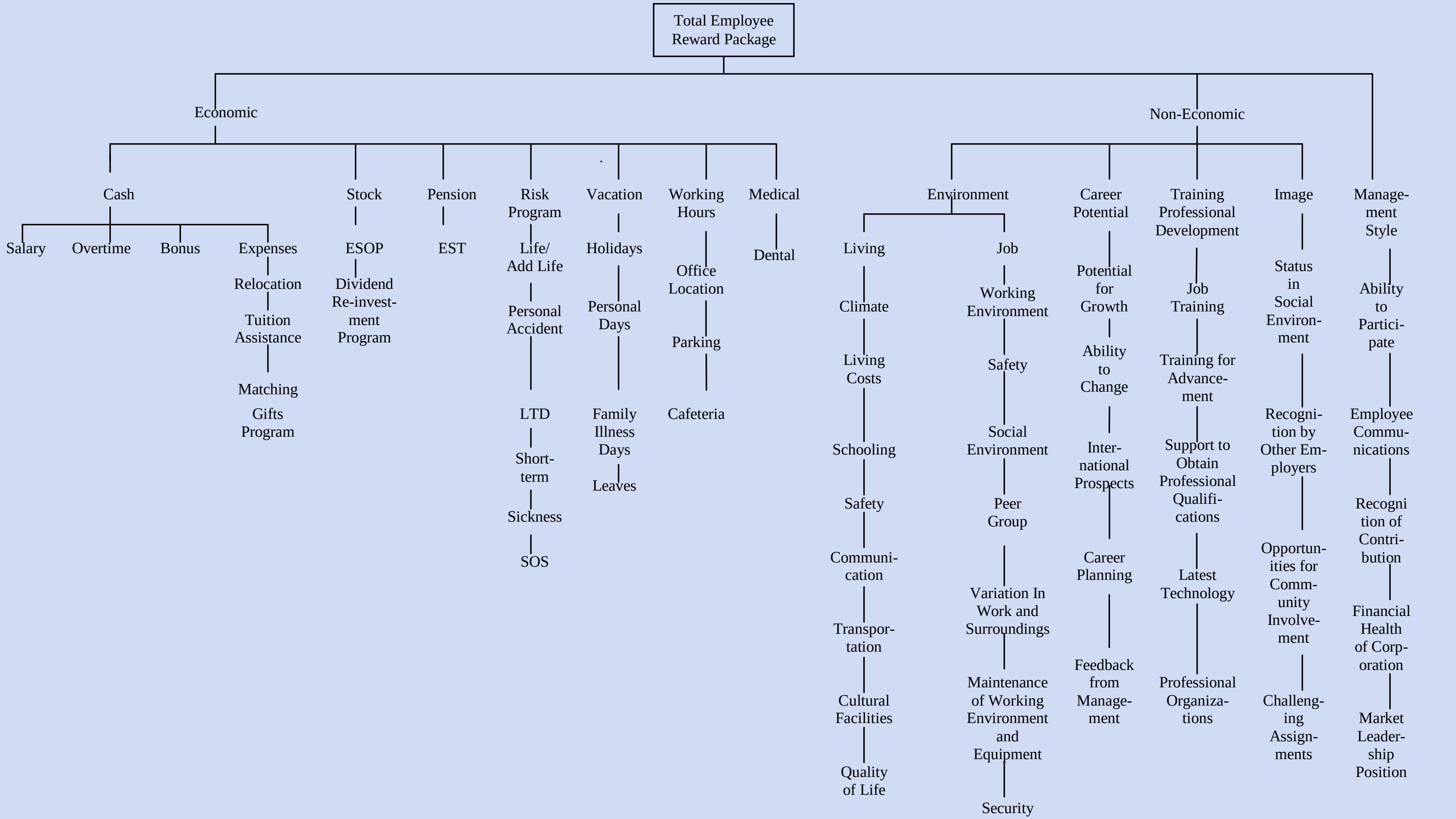
- Help people feel that they are important parts of a whole
- Assume that all human beings have the capacity for excellence and growth
- Undo the damage of employees feeling under-valued and under-appreciated
- Emphasize the rewards of self-motivation and self-improvement through work
- Establish a vision that empowers caring for the people <u>and</u> the product
- Combine the goals of the organization with the goals of the people in it

Characteristics of a Corporate Entrepreneurial Leader *(cont.)*

- Help employees learn how to manage change
- Demonstrate that new ways of doing things are workable
- Encourage new ways of doing things
- Manage by walking around (MBWA)
- Keep the bureaucrats out of the way of productive people
- Fail their way to success
- Develop a well-orchestrated purposeful <u>dis</u>organization

Problem 4
Attracting and Retaining Employees

Compensation Options and Analysis



Source: Adapted from material of Gerard Torma, Director of Compensation and International Human Resources, Nordson Corporation.

Problem 5
Choosing the Right Partner

Key Factors in Evaluating a Firm

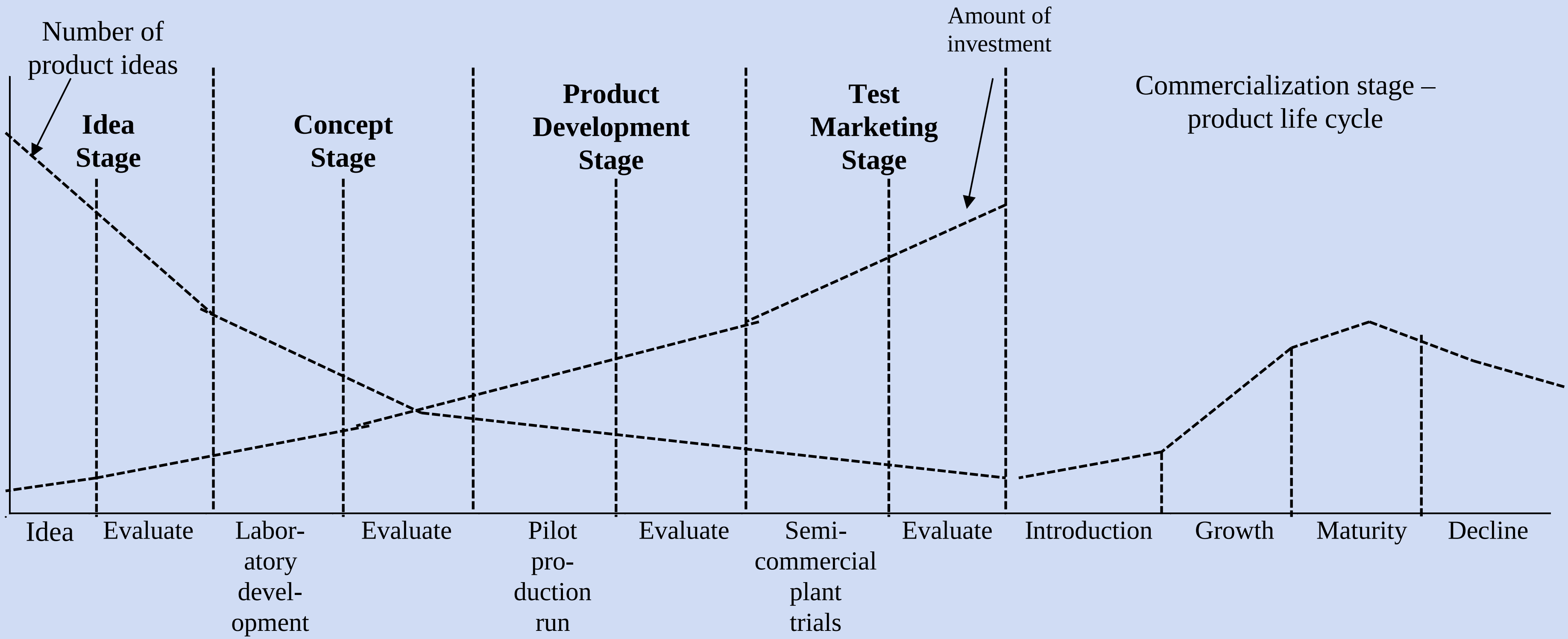
- One-person management
- Poor corporate communications
- Few management tools being used
- Insufficient financial controls
- Highly leveraged--thinly capitalized
- Variations and poorly prepared financial statements
- Sales growth with no increase in bottom line
- Dated and poorly managed inventory
- Aging accounts receivable
- No change in products or customers

Favorable Circumstances for Licensing

- Company lacks capital, managerial resources, knowledge, or commitment to a foreign market.
- Company wants to test viability of a market.
- Technology is not central to company’s core business.
- Strong possibility of acquiring new technology.
- Market too small to warrant any other activity.
- Laws of country restrict other options.
- Risk of nationalization in country too great.
- Licensee could become a future competitor.
- Rapid rate of technological change.

Problem 6
Being Flexible and Creative

The Product Planning and Development Process



Creativity and Problem-Solving Techniques

- Brainstorming
- Reverse brainstorming
- Synectics
- Gordon method
- Checklist method
- Free association
- Forced relationships
- Collective notebook method
- Heuristics

Creativity and Problem-Solving Techniques *(cont.)*

- Scientific method
- Kepner-Tregoe method
- Value analysis
- Attribute listing method
- Morphological analysis
- Matrix charting
- Sequence-attribute/modification matrix
- Inspired (big-dream) approach
- Parameter analysis

Problem 7
Building a Strong Company

Central Concepts of the Mission Statements of Selected U.S. Companies

3M	• Innovation; "Thou shalt not kill a new product idea" • Absolute integrity • Respect for individual initiative and personal growth • Tolerance for honest mistakes • Product quality and reliability
American Express	• Heroic customer service • Worldwide reliability of services • Encouragement of individual initiative
Ford	• People as the source of our strength • Products as the "end result of our efforts" (we care about cars) • Profits as a necessary means and measure for our success • Basic honesty and integrity
General Electric	• Improving the quality of life through technology and innovation • Interdependent balance between responsibility to customers, employees, society, and shareholders (no clear hierarchy) • Individual responsibility and opportunity • Honesty and integrity

Central Concepts of the Mission Statements of Selected U.S. Companies *(cont.)*

Marriott	• Friendly service and excellent value (customers are guests); "make people away from home feel that they're among friends and really wanted" • People are number 1—treat them well, expect a lot and the rest will follow • Work hard, yet keep it fun • Continual self-improvement • Overcoming adversity to build character
Procter & Gamble	• Product excellence • Continuous self-improvement • Honesty and fairness • Respect and concern for the individual

Central Concepts of the Mission Statements of Selected U.S. Companies *(cont.)*

Wal-Mart	• "We exist to provide to our customers"—to make their lives better via lower prices and greater selection; all else is secondary • Swim upstream, buck conventional wisdom • Be in partnership with employees • Work with passion, commitment and enthusiasm • Run lean • Pursue ever-higher goals

Problem 8
Focusing on a Market Niche and Customer

Market Segmentation Techniques by Type of Market

Segmentation Criteria	Basis for Type of Market		
	Consumer	*Industrial*	*Government*
Demographic	age, family size, education level, family life cycle, income, nationality, occupation, race, religion, residence, sex, social class	number of employees, size of sales, size of profit, type of product line	type of agency, size of budget, amount of autonomy
Geographic	region of country, city, size, market density, climate	region of country	federal, state, local
Psychological	personality traits, motives	degree of industrial leadership	degree of forward thinking
Benefits	durability, dependability, economy, esteem enhancement of earnings, status from ownership	dependability, reliability of seller and support service, efficiency in operation or use, enhancement of firm's earnings, durability	dependability, reliability of seller and support services
Volume of Use	heavy, medium, light	heavy, medium, light	heavy, medium, light
Controllable Marketing Elements	sales promotion, price, advertising, guarantee, warranty, retail store purchased service, product attributes, reputation of seller	price, service, warranty, reputation of seller	price, reputation of seller

Source: Robert D. Hisrich, *Marketing*, 2nd edition, Hauppauge, NY: Barron's Educational Series, 2000, p. 77.

Market Grid Examples for the Services of a New Commercial Bank for the Industrial Market

Type of Business / Bank Service	Insurance and real estate	Construction	Wholesale trade	Utilities	Transportation	Service Industries	Retail trade	Manu-facturing
Commercial loans								
Checking accounts								
Savings accounts								
Safe-deposit box								
Branch banking								
After-hours depository								
Bank-by-mail								
Lock box plan								
Account recon -cilement plan								
Freight payment plan								
Payroll accounting plan								
All others								

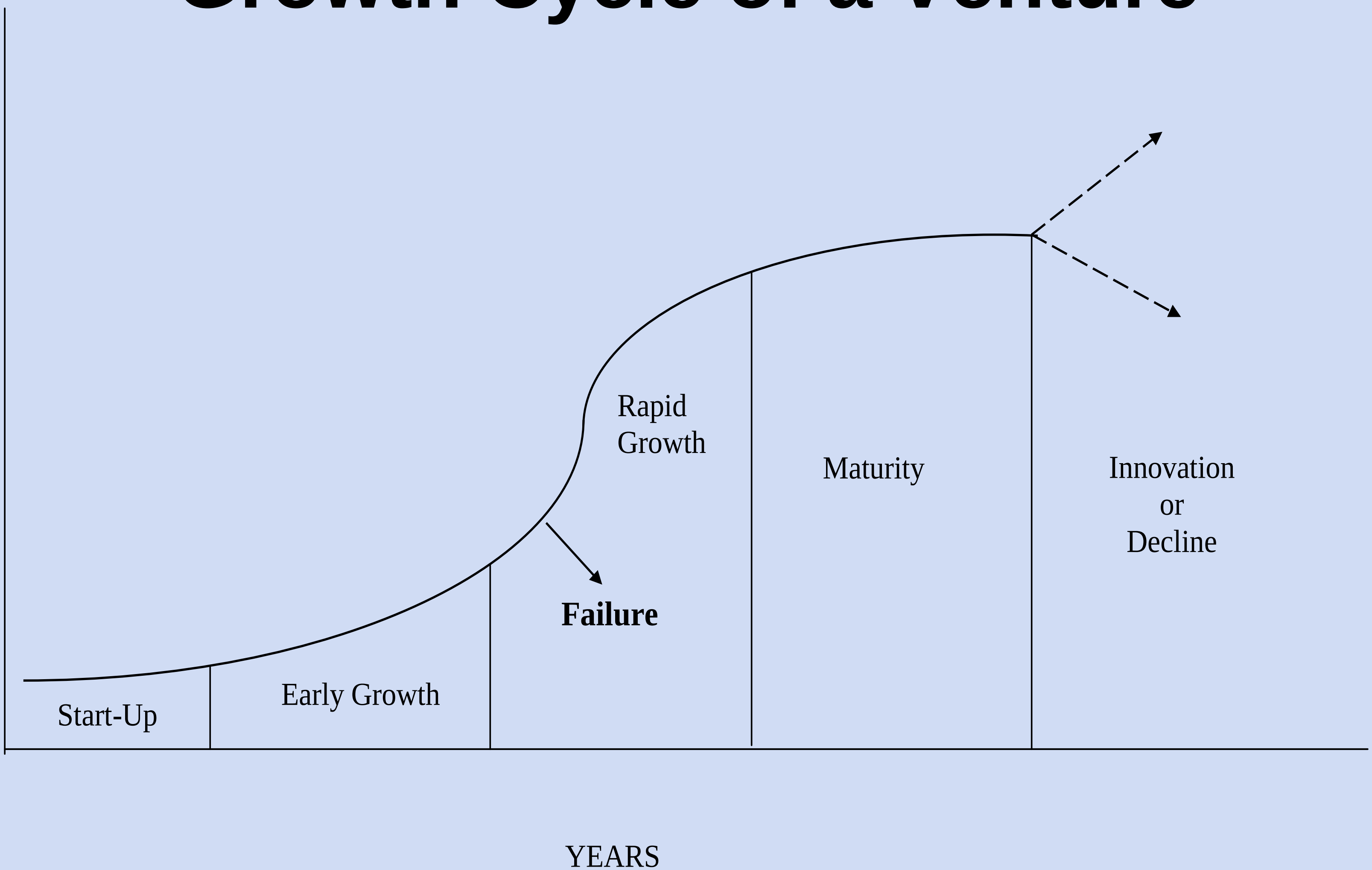
Problem 9
Going International

Methods for Doing Global Business

- **Exporting**
  - Indirect Exporting
    - Foreign purchaser in a local market
    - Export management firm
  - Direct Exporting
    - Independent foreign distributors
    - Overseas sales office
- **Non Equity Arrangements**
  - Licensing
  - Turn-key Projects
  - Management Contracts
  - Partnering Agreements
  - Franchising
- **Direct Foreign Investment**
  - Minority Interests
  - Joint Ventures
  - Majority Interests

Problem 10
Growing Your Business

Growth Cycle of a Venture



Problem 11
Raising Capital

Alternative Sources of Financing

Source of Financing	Length of Time		Cost			Control	
	Short-term	Long-term	Fixed Rate Debt	Floating Rate Debt	Equity	Covenants	Voting Rights
Self		X			X	X	X
Family and Friends	X	X	X	X	X	X	X
Suppliers and Trade Credit	X						
Commercial Banks	X		X	X		X	
Government Programs		X					
Private Equity Placements		X			X	X	X
Public Equity Offerings		X			X		X
Angel Financing		X			X	X	X
Venture Capital Financing		X			X	X	X

Bank Loans

Bank Lending Decisions

• Character • Capacity • Capital	• Collateral • Conditions

Types of Bank Loans

• Accounts Receivable Loans • Equipment Loans • Inventory Loans • Real Estate Loans	• Character Loans • Installment Loans • Long-term Loans • Straight Commercial Loans

Private Equity Market
(Enterprise Capital)

- **Individuals**
  - Individuals
  - Angel Groups (networks)
  - Angel Funds
  - Family Offices
- **Venture Capital Firms**
  - Private Venture Capital Firms
  - Small-Business Investment Companies (SBIC)
  - Industry Sponsored Venture Capital Firms
    - Banks and other financial institutions
    - Nonfinancial companies
  - Regionally Oriented Venture Capital Firms
  - University Sponsored Venture Capital Firms
- **Private Equity Firms**
  - Limited Partners
  - General Partners

Problem 12
Managing the Cash

Example Statement of Cash Flows

(For the Year Ended December 31, 2002
Amounts is thousand dollars)

Cash flows from operating activities:		
Receipts:		
Collections from customers	244	
Interest received on notes receivables	8	
Total Cash Receipts		252
Payments:		
To Suppliers	(120)	
To Employees	(53)	
For Interest	(14)	
For Income Tax	(10)	
Total Cash Payment		(197)
Net Cash Inflow from Operating Activities		55
Cash Flows from Investing Activities:		
Acquisition of small equipment	(10)	
Acquisition of machinery	(150)	
Net Cash Outflow from Investing Activities		(160)
Cash Flows from Financing Activities:		
Proceeds from Issuance of Long Term Debt	70	
Proceeds from Bank Loan	20	
Net Cash Inflow from Financing Activities		90
Net Decrease in Cash		(15)
Cash Balance December 31, 2001		20
Cash Balance December 31, 2002		5

Days in the Cash Cycle

Area	Calculation	
Days in Raw Materials Inventory	Average Raw Materials Inventory / Cost of Raw Materials	X 365 Days
Days in Work in Process Inventory	Average Work in Process Inventory / Cost of Goods Sold	X 365 Days
Days in Finalized Goods Inventory	Average Finalized Good Inventory / Cost of Goods Sold	X 365 Days
Days in Accounts Receivable	Average Accounts Receivable / Credit Sales	X 365 Days
Days in Accounts Payable	Average Accounts Payable / Cost of Goods Sold - Labor	X 365 Days

Cash Flow Statement Changes

Cash from Operating Activities	+	Cash from Investing Activities	+	Cash from Financing Activities	=	Change in Cash
Net income adjusted for: a. Noncash expenses or revenues b. gains or losses on sales of long term assets c. changes in current assets or liabilities		a. cash used to buy long term assets b. cash from sale of long term assets		a. cash from sale of stock b. cash used to purchase stock c. cash from long term debt (loan) d. cash used to pay off long term debt (loan) e. payments of cash dividends		

The Cash Cycle

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Problem 13
Valuing a Business

Methods for Valuation of a Venture

Method	Description/Explanation
Fixed price	• Two or more owners set initial value. • Based upon what owners “think” business is worth. • Uses figures from any one or combination of methods. • Common for buy/sell agreements.
Book value (known as balance sheet method) 1. Tangible 2. Adjusted tangible	1. *Tangible book value*: Set by the business’s balance sheet. Reflects net worth of the firm. Total assets less total liabilities (adjusted for intangible assets). 2. *Adjusted tangible book value*: Uses book value approach. Reflects fair market value for certain assets. Upward/downward adjustments in plant and equipment, inventory, and bad debt reserves.

Methods for Valuation of a Venture *(cont.)*

Method	Description/Explanation
Multiple of earnings	• Net income is capitalized using a price/earnings ratio (net income multiplied by P/E number). • 15% capitalization rate is often used (equivalent to a P/E multiple of 6.7, which is 1 divided by 0.15). • High-growth businesses use lower capitalization rate (e.g., 5%, which is a multiple of 20). • Stable businesses use higher capitalization rate (e.g., 10%, which is a multiple of 10). • Derived value is divided by number of outstanding shares to obtain per-share value.
Price/earnings ratio (P/E)	• Similar to return on investment approach. • Determined by price of common stock divided by after-tax earnings. • Closely held firms must multiply net income by an appropriate multiple, usually derived from similar publicly traded corporations. • Sensitive to market conditions (prices of stocks).

Methods for Valuation of a Venture *(cont.)*

Method	Description/Explanation
Discounted future earnings (discounted cash flow)	• Attempts to establish future earning power in current dollars. • Projects future earnings (5 years), then calculates present value using a discounted rate. • Based on "timing" of future income that is projected.
Return on investment (ROI)	• Net profit divided by investment. • Provides an earnings ratio. • Need to calculate probabilities of future earnings. • Combination of return ratio, present value tables and weighted probabilities.
Replacement value	• Based on value of each asset if it had to be *replaced* at current cost. • Firm's worth calculated as if building from "scratch." • Inflation and annual depreciation of assets are considered in raising the value above the reported book value. • Does *not* reflect earning power or intangible assets.

Methods for Valuation of a Venture *(cont.)*

Method	Description/Explanation
Liquidation value	• Assumes business ceases operation. • Sells assets and pays off liabilities. • Net amount after payment of all liabilities is distributed to shareholders. • Reflects “bottom value” of a firm. • Indicates amount of money that could be borrowed on a secured basis. • Tends to favor seller since all assets are valued as if converted to cash.
Excess earnings	• Developed by the U.S. Treasury to determine a firm’s intangible assets (for income tax purposes). • Intent is for use only when there is no better method available. • Internal Revenue Service refers to this method as a last resort. • Method does not include tangibles with estimated useful lives (i.e., patents, copyrights).

Methods for Valuation of a Venture *(cont.)*

Method	Description/Explanation
Market value	• Needs a “known” price paid for a similar business. • Difficult to find recent comparisons. • Methods of sales may differ—installment vs. cash. • Should be used only as a reference point.

Steps in Valuing Your Business and Determining Investors' Share

1. Estimate the earnings after taxes based on sales in the fifth year.
2. Determine an appropriate earnings multiple based on what similar companies are selling for in terms of their current earnings.
3. Determine the required rate of return.
4. Determine the funding needed.
5. Calculate, using the following formulas

$$\text{Present Value} = \frac{\text{Future valuation}}{(1 + i)^n}$$

where:

future valuation = total estimable value of company in 5 years

i = required rate of return

n = number of years

$$\text{Investor's share} = \frac{\text{Initial funding}}{\text{Present value}}$$